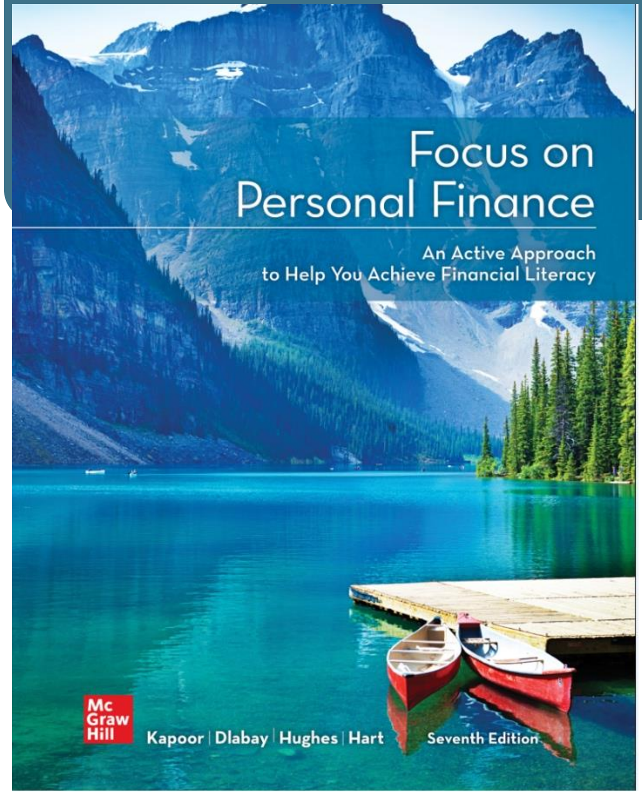

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Chapter 8

Home and Automobile Insurance

Home and Automobile Insurance
Chapter Learning Objectives

LO8.1 Identify types of risks and risk management methods, and develop a risk management plan.

LO8.2 Assess the insurance coverage and policy types available to homeowners and renters.

LO8.3 Analyze the factors that influence the amount of coverage and cost of home insurance.

LO8.4 Identify the important types of automobile insurance coverage.

LO8.5 Evaluate factors that affect the cost of automobile insurance.

Insurance and Risk Management

LO8.1

- **Insurance** is protection against possible financial loss
- An **insurance company (*insurer*)** is a risk-sharing firm that assumes financial responsibility for losses that may result from an insured risk
- A person joins the risk-sharing group by purchasing a contract, known as a **policy**
  - Purchaser of policy is called a **policyholder**, and they pay the insurance company a **premium**, or fee
- Protection provided by the terms of the insurance policy is known as **coverage**
- People protected by the policy are called **insureds**

Types of Risk

- **Risk** is the chance of loss or injury
  - Insurers often refer to the insured property or person as the risk
- **Peril** is anything that may possibly cause a loss
  - Policies protect against a wide range of perils, including fire, windstorms, explosions, robbery, and accidents
- **Hazard** is anything that increases the likelihood of loss through some peril
  - *Example*: Defective house wiring is a hazard that increases the change that a fire will start

Types of Risk (Continued)

- Most common risks are personal risks, property risks, and liability risks
  - *Personal risks* involve loss of income or life due to illness, disability, old age, or unemployment
  - *Property risks* include losses to property caused by perils, such as fire or theft, and hazards
  - *Liability risks* involve losses caused by negligence that leads to injury or property damage
    - **Negligence** is the failure to take ordinary or reasonable care to prevent accidents from happening
- Personal risks, property risks, and liability risks are types of *pure*, or *insurable*, *risk*
  - *Speculative risk* carries a change of either loss or gain

Risk Management Methods

- *Risk management* is an organized plan for protecting yourself, your family, and your property
  - **Risk avoidance** involves eliminating risks altogether
    - *<u>Example</u>*: Avoid risk of traffic accident by not driving to work
  - **Risk reduction** decreases the likelihood risks will cause you harm
    - *<u>Examples</u>*: Wearing a seatbelt and installing fire extinguishers
  - **Risk assumption** means taking on responsibility for the negative results of a risk
    - *<u>Example</u>*: Not purchasing collision insurance on an older car
  - **Risk shifting** involves transferring risk to an insurer
    - **Deductible** is the set amount the policyholder must pay per loss on an insurance policy

Risks and Risk Management Strategies

RISKS		STRATEGIES FOR REDUCING FINANCIAL IMPACT		
Personal Events	**Financial Impact**	**Personal Resources**	**Private Sector**	**Public Sector**
Disability	Loss of one's income Increased expenses	Savings, investments	Disability insurance	Disability insurance
Illness	Loss of one's income Catastrophic hospital expenses	Health-enhancing behavior	Health insurance Health maintenance organizations	Military health care Medicare, Medicaid
Death	Final expenses	Estate planning Risk reduction	Life insurance	Veteran's life insurance Social Security survivor's benefits
Retirement	Decreased income Unplanned living expenses	Savings Investments Hobbies, skills	Retirement and/or pensions	Social Security Pension plan for government employees
Property loss	Catastrophic storm damage to property Repair or replace-ment cost of theft	Property repair and upkeep Security plans	Automobile insurance Homeowner's insur-ance Flood insurance (joint program with government)	Flood insurance (joint program with business)
Liability	Claims and settle-ment costs Lawsuits and legal expenses Loss of personal assets and income	Observing safety pre-cautions Maintaining property	Homeowner's insurance Automobile insurance Malpractice insurance	

Planning an Insurance Program

1. **Set insurance goals**
   - Reduce possible loss of income caused by premature death, illness, accident, or unemployment
   - Reduce possible loss of property caused by perils, such as fire or theft, or hazards
   - Reduce possible loss of income, savings, and property because of personal negligence

Planning an Insurance Program (Continued)

2. **Develop a plan to reach your goals**
   - What do you need to insure?
   - How much should you insure it for?
   - What kind of insurance should you buy?
   - Who should you buy insurance from?

3. **Put your plan into action**

2. **Check your results**
   - Insurance needs and goals change, so take time to review your plan frequently

Creating a Personal Insurance Program

Exhibit 8-2

Property and Liability Insurance in Your Financial Plan

- Major natural disasters have caused catastrophic amounts of property loss in the U.S. and other parts of the world
  - **2017** – Hurricanes Harvey, Irma, Jose, and Maria caused over $100 billion in property damage
  - **2019** – Tropical storm Nestor and Hurricane Dorian caused economic losses of over $22 billion
- Two main types of risk are related to your home and your car or other vehicle:
  1. Risk of damage to or loss of your property
  2. Your responsibility for injuries to other people or damage to their property

Potential Property Losses and Liability Protection

- Property owners face two basic types of risk:
  1. Physical damage caused by perils such as fire, wind, water, and smoke
  2. Loss or damage caused by criminal behavior, such as robbery, burglary, vandalism, and arson
- **Liability** is legal responsibility for the financial cost of another person's losses or injuries
  - You can be held legally responsible even if the injury or damage was not your fault
  - Often, if you're found liable, it's because negligence on your part caused the mishap

Home and Property Insurance
LO8.2

- **Homeowner's insurance** is coverage for a place of residence and its associated financial risks, such as damage to personal property and injury to others
- Renter's insurance includes coverage for personal property, additional living expenses, as well as personal liability and related coverage
  - Does not provide coverage on the building or other structures
  - Two standard renter's insurance policies:
    - *Broad form* covers your personal property against perils specified in the policy, such as fires and thefts
    - *Comprehensive form* protects your personal property against all perils not specifically excluded in the policy

Renter's Insurance

- When shopping for renter's insurance, be aware that these policies:
  - Normally pay only the actual cash value of your losses;
  - Fully cover your personal property only at home;
  - Automatically provide liability coverage if someone is injured on your premises; and
  - May duplicate other coverage
- Most important part of renter's insurance is the protection it provides for your personal property

Homeowner’s Insurance Coverages

- Homeowner’s insurance policy provides coverage for the following:
  - The building in which you live and any other structures on the property;
  - Additional living expenses;
  - Personal property;
  - Personal liability and related coverage; and
  - Specialized coverage

Building and
other structures

Personal
property

Loss of use/additional living
expenses while home is
uninhabitable

Personal liability and
related coverages

Homeowner's Insurance Coverages:

Building and Other Structures & Additional Living Expenses

- **Building and Other Structures**
  - Main purpose of homeowner's insurance is to protect you against financial loss in case your home is damaged or destroyed
  - Detached structures on your property, such as a garage or toolshed, are also covered
- **Additional Living Expenses**
  - Pays for you to stay somewhere else (e.g., motel/apartment) if your home is damaged by fire or some other event
  - Some policies limit additional living expense coverage to 10 to 20 percent of the home's coverage amount and/or limit payments to a maximum of six to nine months

Homeowner's Insurance Coverages: Personal Property

- Covers your household belongings, such as furniture, appliances, and clothing, up to a portion of the insured value of the home
  - The portion is usually 55, 70, or 75 percent
- Typically limits the payout for the theft of certain items
- Provides protection against the loss or damage of articles that you take with you when you are away from home
- **Household inventories** are lists or other documentation of personal belongings, with purchase dates and cost information
- **Personal property floaters** cover damage or loss of a specific item of high value

Household Inventory Contents

Exhibit 8-4

Exhibit 8–4
Household Inventory Contents

Homeowner's Insurance Coverages:
Personal Liability and Related Coverage

- Protects you and members of your family if others sue you for injuries they suffer or damage to their property
  - Includes the cost of legal defense
- Basic personal liability coverage of $100,000 in most homeowner's policies
  - **Umbrella policies** are supplementary personal liability coverages
- **Medical payments coverage** pays the cost of minor accidental injuries to visitors on your property
  - Generally $5,000 in coverage

Home Insurance Policy Forms

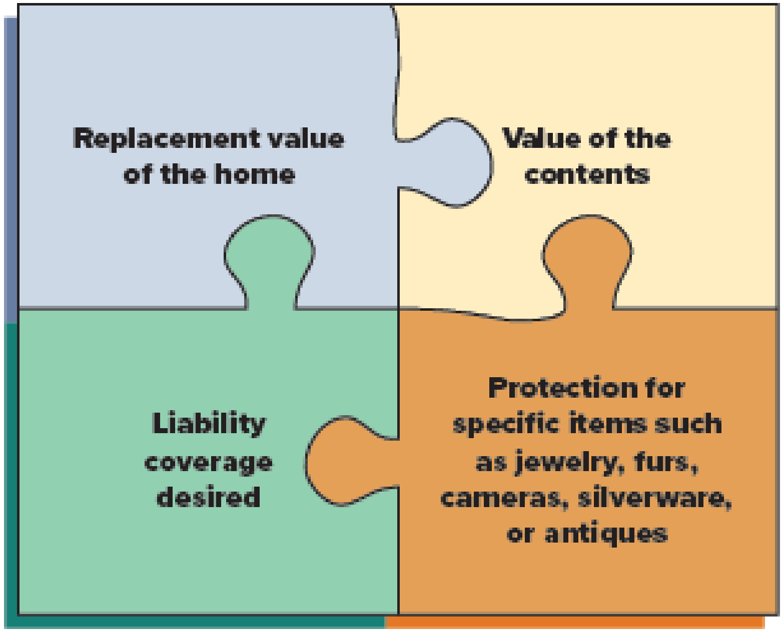
- **Basic form (HO-1)** protects against perils such as fire, lightning, windstorms, hail, volcanic eruptions, explosions, smoke, theft, vandalism, glass breakage, and riots
- **Broad form (HO-2)** offers wider coverage, including falling objects and damage from ice, snow, or sleet
- **Special form (HO-3)** covers all basic- and broad form-risks, plus any other risks unless specifically excluded
  - Common exclusions are earthquake, flood, war, or nuclear accidents

Home Insurance Policy Forms (Continued)

- **Tenant's form (HO-4)** covers the personal property of renters against listed risks
- **Comprehensive form (HO-5)** expands the coverage of the HO-3
- **Condominium owner's insurance (HO-6)** protects personal property and additions or improvements made to the living unit
- Home insurance policies usually cover items such as credit card fraud, check forgery, temporary repairs, the cost of removing damaged property, the emergency removal of property, and fire department charges (in areas with such fees)

Home Insurance Cost Factors
LO8.3

- Coverage amount should be based on the amount of money you would need to rebuild or repair your house
- How are claims settled?
  - **Actual cash value (ACV) method** pays insured based on the current replacement cost of a damaged or lost item, less depreciation
  - **Replacement value method** pays insured the full cost of repairing or replacing a damaged or lost item

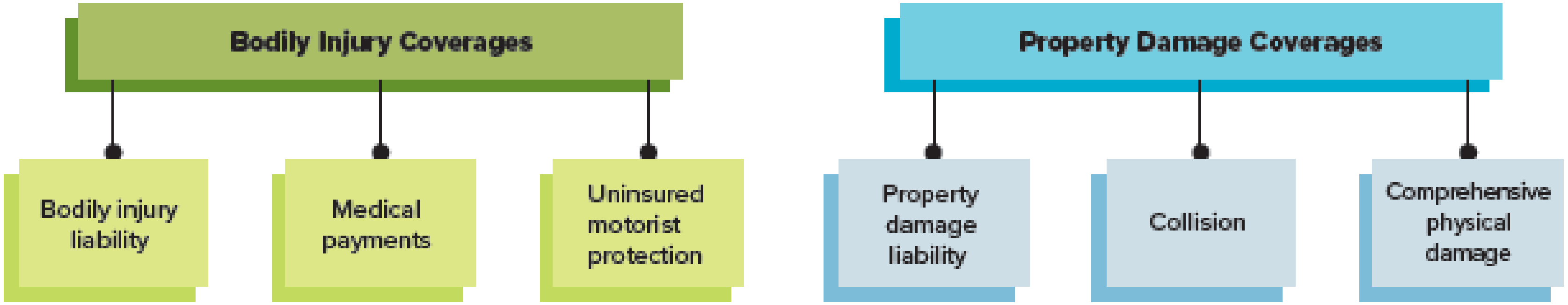


Factors That Affect Home Insurance Costs

- **Location of Home**
  - Lower rates if home is near a water supply or fire hydrant or located in an area that has a good fire department
  - Higher rates in high-crime areas, as well as areas that experience severe weather, such as tornados and hurricanes
- **Type of Structure**
  - Brick homes cost less to insure than those made of wood
- **Coverage Amount and Policy Type**
  - Deductibles also affect the cost of insurance
- **Home Insurance Discounts**
  - Alarm system, smoke detectors, fire extinguishers, etc.
- **Company Differences**
  - Compare cost, coverage, and service

Automobile Insurance Coverages
LO8.4

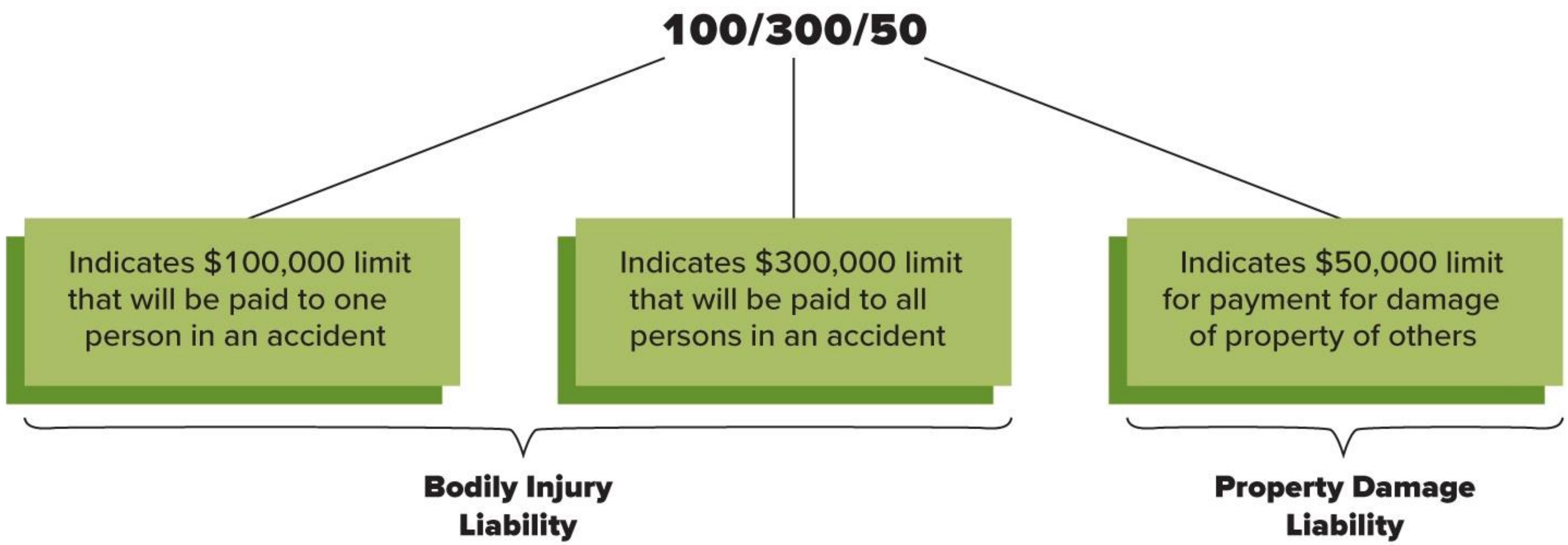
- **Financial responsibility law** requires drivers to prove their ability to cover the cost of damage or injury caused by an automobile accident
  - Every state in the U.S. has a financial responsibility law
- Coverage provided by motor vehicle insurance falls into two categories:
  - Protection for bodily injury
  - Protection for property damage



Motor Vehicle Bodily Injury Coverages

- **Bodily injury liability** covers financial loss due to legal expenses, medical expenses, lost wages, etc. associated with injuries *caused by an accident for which the insured was responsible*
  - Coverage is expressed as 3 numbers, such as 100/300/50
    - $100,000 maximum paid for injuries to any one person
    - $300,000 maximum paid to all injured parties (2 or more)
    - $50,000 maximum paid for property damage to others
- **Medical payments coverage** in automobile insurance covers medical expenses for people injured in the insured's car
- **Uninsured motorist protection** covers you and your family members if you are involved in an accident with an uninsured or hit-and-run driver

Automobile Liability Insurance Coverage
Exhibit 8-8



Motor Vehicle Property Damage Coverage

- **Property damage liability** protects a person against financial loss when that person damages the property of others
  - Also protects you when you're driving another person's vehicle with the owner's permission
  - Coverage extends to buildings and to equipment, such as street signs and telephone poles
- **Collision insurance** pays for damage to the insured's vehicle when it is involved in an accident
- *Comprehensive physical damage coverage* protects you if your vehicle is damage is a nonaccident situation
  - Protects your vehicle against fire, theft, vandalism, flood, etc.

No-Fault Insurance and Other Coverages

- Under a **no-fault system**, drivers involved in accidents collect medical expenses, lost wages, and related injury costs from their own insurance companies
  - It does not matter who caused the accident
  - Each company pays the insured up to the limits of his or her coverage
  - No-fault systems vary by state
- Other types of motor vehicle insurance are available:
  - *Wage loss insurance*
  - *Towing and emergency road service coverage*
  - *Rental reimbursement coverage*

Automobile Insurance Costs
LO8.5

- Average household spends more than $1,200 for motor vehicle insurance yearly
- You need enough coverage to protect yourself legally and financially
  - **Legal concerns:** Most people cannot afford to pay an expensive court settlement with their own money, so liability insurance is purchased
    - Coverage of 100/300 is usually recommended
  - **Property values:** Cost of vehicles has increased, so a property damage liability limit of $50,000 or $100,000 should be considered

Motor Vehicle Insurance Premium Factors

- **Vehicle type**
  - Year, make, model, and theft rate affect insurance costs
- **Rating territory**
  - Rural areas usually have fewer accidents and less frequent occurrences of theft; as such, rates are generally lower
- **Driver classification**
  - Age, sex, marital status, driving record, and driving habits
    - Young drivers (under 25) and elderly drivers (over 70) have more frequent and more serious accidents
  - Cost and number of claims also affect premiums
  - **Assigned risk pool** consists of people unable to obtain insurance due to poor driving or accident records; must obtain coverage at high rates through a state program

Motor Vehicle Insurance Premium Factors

Reducing Vehicle Insurance Premiums

- **Compare companies**
  - Rates and services vary, even up to 100% in the same area
  - Also compare service and rates of local insurance agents
- **Premium discounts**
  - Establish and maintain a good driving record
  - Non-smoker
  - Install security devices
  - If you have more than one vehicle, insure with the same company
  - Consider increasing your deductible
  - Choose your car carefully
  - Maintain a good credit history

Chapter Summary

LO8.1: Identify types of risks and risk management methods, and develop a risk management plan.

- The main types of risk are *personal risk*, *property risk*, and *liability risk*.
- Risk management methods include *avoidance*, *reduction*, *assumption*, and *shifting*.
- Planning an insurance program is a way to manage risks.
- Property and liability insurance protect your homes and motor vehicles against financial loss.

Chapter Summary

LO8.2: Assess the insurance coverage and policy types available to homeowners and renters.

- *Renter's insurance* provides many of the same kinds of protection as homeowner's policies.
- A *homeowner's policy* provides coverage for the following:
  - Buildings and other structures
  - Additional living expenses
  - Personal property
  - Personal liability and related coverages
  - Specialized coverages

Chapter Summary

LO8.3: Analyze the factors that influence the amount of coverage and cost of home insurance.

- Factors that affect home insurance coverage and costs include the following:
  - Location
  - Type of structure
  - Coverage amount
  - Policy type
  - Discounts
  - Choice of insurance company

Chapter Summary

LO8.4: Identify the important types of automobile insurance coverage.

- *Motor vehicle bodily injury coverages* include the following:
    - Bodily injury liability
    - Medical payments coverage
    - Uninsured motorist's protection
- *Motor vehicle property damage coverages* include the following:
    - Property damage liability
    - Collision
    - Comprehensive physical damage

Chapter Summary

LO8.5: Evaluate factors that affect the cost of automobile insurance.

- Motor vehicle insurance costs depend on the following:
  - Amount of coverage needed
  - Vehicle type
  - Rating territory
  - Driver classification